WRITTEN COMMENTS

OF

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SUBCOMMITTEE ON ENERGY AND POWER

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Thank you Chairman Schaefer, and members of the Energy and Power Subcommittee, for the opportunity to participate in your field hearings on electric utility restructuring.

I comment today on behalf of the private citizens and business citizens of Michigan. I want to keep utility rates competitive so Michigan ratepayers can obtain the power they need at reasonable prices. I want to keep rates competitive so that businesses and families can afford to do business and live in Michigan. It is a well–known fact that businesses build and expand in states where the cost of doing business is reasonable.

By its Order Number 888 the Federal Energy Regulatory Commission ("FERC") further opened the wholesale electricity market to competition.

However, I believe that a competitive electricity market cannot be achieved if competition is limited to wholesale transactions. A utility has no incentive to control costs, to innovate, or even to buy the most economical power available in the wholesale market if its retail customers are captive.

That is why I have urged the Michigan legislature as long ago as 1985 that impediments to competition within utility service territories should be eliminated. And that is why I tell you today, competition in the electricity market can and will benefit all customers, if the market is properly restructured.

Experience in the natural gas industry shows that rates came down for all retail classes of customers when the industry was deregulated. In Michigan, even

residential and small business customers benefited from the movement to a competitive marketplace, although to a lesser degree than large customers.

I believe there can be little doubt that increasing competition in the electric power industry will yield a more efficient industry. Competition will provide additional choices to consumers, allocate resources more efficiently and, if full competition in generation develops, prices for electricity should fall, at least on average. The recent rapid growth of non-utility generators shows that the generation sector of the industry is susceptible to competition. Wholesale electric competition has already begun to pay dividends to consumers and retail competition will increase competitive pressures on incumbent utilities and should reduce prices further.

However, in a competitive environment a customers' bargaining power and specific load characteristics will determine the price paid for electricity. This could work to the advantage of the largest customers of the electric utilities and to the detriment of smaller customers.

I am disappointed to tell this Subcommittee that the restructuring plan presently under consideration in Michigan allows all business customers direct access to the power provider of their choice in 2001, but does not allow residential customers similar access until 2004. A plan that does not permit all customers to have simultaneous access to power providers is a mistake. Commercial and industrial interests must not be permitted to lock up available low-cost power, leaving only higher priced power for residential customers. The goal of restructuring must be to bring the benefits of a competitive generation market to all customers, not just a few.

Some say, if we go to a competitive market where there is choice, "the big dogs will eat first." Well let me tell you, in Michigan, the big dogs have already eaten. Thirty-one industrial and large commercial customers, among them General Motors, Ford and Chrysler, are already feasting on

below-tariff special contract rates. In fact, I estimate that one-third of Consumers Energy's total industrial sales are discounted. I can assure you that Michigan's investor owned utilities have not offered below–tariff rates to their residential customers. Absent access to competitive generation markets, the chasm in Michigan will only widen between the industrials and the small business and residential classes.

I believe federal legislation can accelerate the move to increased electric competition not by prescribing the details and timing of restructuring, but by removing barriers to restructuring and addressing uniquely federal issues. Congress should consider legislation that clarifies state authority to order transmission access for retail sales, addresses reciprocity policies among states and clarifies boundaries between federal and state regulation.

We know from the experience of the introduction of competition in the local telecommunications market that jurisdictional uncertainties can impede competition. As you know, the Federal Communications Commission's ("FCC") pro-competition rules have been stayed by the Court of Appeals at the request of local phone companies.

Although I believe that Michigan currently possesses adequate authority to order competitive reforms, many utilities express the view that states cannot implement retail wheeling because FERC has exclusive jurisdiction over transmission of electricity in interstate commerce under the Federal Power Act ("FPA"). Because FERC is expressly prohibited from ordering the transmission of energy directly to an ultimate consumer, the utilities argue that neither the states nor FERC can compel a utility to engage in retail wheeling.

Federal legislation should leave no doubt of the states' abilities to require access to transmission

facilities to implement retail competition.

Action by Congress should also include review of the Public Utility Holding Company Act ("PUHCA") and the Public Utility Regulatory Policy Act ("PURPA") to insure that these acts encourage the development of competition while at the same time insuring that captive consumers, and competitors, are not vulnerable to abuses by monopolies with market power over transmission, distribution and retail service.

Market power concerns are very real to Michigan's citizens. The restructuring plan presently under review in Michigan provides for the virtual deregulation of Michigan's monolithic utilities. While Detroit Edison and Consumers Energy serve 85% to 90% of the electric consumption in Michigan, it is not at all clear that the few and limited interconnection points between Michigan and neighboring states are able to carry sufficient capacity to create competition in Michigan's market. Moreover, there is scarce independent power producer (IPP) capacity available within our state. Thus, in Michigan deregulation presents the specter of deregulation without competition, creating in our two incumbent utilities unfettered market power which creates concern about price gouging and predatory pricing.

Until utility market power is eliminated, consumers must be protected by effective regulation of multistate holding companies. If PUHCA were repealed today in the way proposed in Senate Bill 621, neither the remaining regulatory scheme nor the current state of competition would be sufficient to protect consumers. And Senate Bill 621 concerns not just the states in which the 15 registered holding companies are located, but it concerns all states because if PUHCA is repealed, numerous mergers leading to vast multistate structures designed to evade state regulation will take place. Even with PUHCA in place, there are presently ten major electric mergers currently pending before the FERC.

Congress should also address reciprocity policies among states to insure that such provisions do not thwart efforts to create competition.

And Federal legislation should include consumer safeguards to prevent the kinds of fraud and abuse that occurred in telecommunications deregulation where consumers have unwittingly paid $15.00 for a three minute call, or had their service provider cancelled without their knowledge or consent.

Because the environmental implications of restructuring are not yet fully understood, Congress should address the environmental effects that may flow from restructuring.

And finally, requirements for renewable resources in generation portfolios must also be considered. The move away from regulation to competitive regional generation markets will make it difficult for state regulators to enforce portfolio standards for renewable energy. This is an especially appropriate issue for congressional action.

What Congress must not do is preempt state regulatory commissions' authority by requiring the recovery of stranded costs. "Stranded costs" measures the potential gain that consumers would

realize if electricity prices moved immediately to market prices and utilities absorbed the stranded costs. Put another way, customers will be no better off from restructuring if full stranded costs are paid by ratepayers.

The courts have repeatedly rejected claims that utilities are guaranteed full recovery of stranded costs. The United States Supreme Court has said "The Due Process Clause . . . has not and cannot be applied to insure values or to restore values that have been lost by the operation of economic forces." *Market Street Railway Co. v. Railroad Commission of California*, 324 U.S. 548, 567 (1945) *reh den* 324 U.S. 890 (1945)

In *Cajun Electric Power v. FERC*, 28 F.3d 173, 179 (D.C. Cir, 1994), the United State Court of Appeals for the D.C. Circuit two years ago reviewed a case involving Entergy Corporation's request for recovery of stranded costs due to wholesale customers purchasing power from competitive entities. The court held that "Entergy always has the option to reemploy [its] productive resources by making off–system sales at market-based prices. Hence, there really is no such thing as stranded investment, only a failure to compete . . . in this sense, a stranded investment provision is the antithesis of competition."

The notion that there should be no stranded cost recovery is not novel. Professor Peter Navarro of the Graduate School of Management at the University of California wrote recently in the *Harvard Business Review* that "Allowing full

recovery of [stranded costs] is unfair to consumers . . . [and] will defeat the purpose of restructuring."

Utilities, not regulatory commissions, make investment decisions. In the end, the utility should benefit or suffer based upon the quality of its business decisions. Last month a coalition of national and state public interest groups put it best when it stated: "Stranded-cost recovery should be a burden for utility shareholders, not ratepayers. Utilities must take responsibility for making big business decisions that result in uneconomical power plants."

In Michigan, over three quarters of Consumers Energy's request for $4 billion in stranded cost recovery relates to a purchased power contract it entered into with its affiliate, the Midland Cogeneration Venture. A similarly large percentage of Edison's stranded costs arise from the Fermi 2 nuclear plant.

Neither the Midland purchased power contract nor the construction of Fermi 2 was forced on the utilities -- Midland Cogeneration Venture and Fermi 2 were forced upon the ratepayers. These decisions were not ordered by the Commission, and the utilities and their shareholders must take responsibility for making them.

As a representative of the Ford Motor Company explained to the United States Senate Energy and Natural Resources Committee in March of this year, "The issue of stranded costs appears to be a major roadblock in the transition to a competitive industry, but it is not fair to ask retail customers to bear the full burden of a utility's stranded costs. In most cases, they did not ask for support or sign for the high-cost nuclear plants or the high-priced independent power contracts now plaguing utilities. In fact, consumer groups in many states actively opposed such high costs projected when

they were originally conceived."

To find a good example of the negative impact a decision to permit stranded costs can have on the creation of a competitive market one need look no further than Michigan's Alma. The City of Alma has for the last couple of years undertaken efforts to municipalize, only to be met by huge assessments of stranded costs by the incumbent utility, Consumers Energy. The utility claims stranded cost recovery is due under FERC Order 888, even though the utility has filed document after document indicating it is a capacity deficient utility.

Thank you for the opportunity to share my views with you.